

restore the property to the non-luxury standard adequate for the rental market for which the project was originally approved. If the standard has changed over time, the rehabilitation may include improvements to meet the current standards. The rehabilitation also may include the addition of significant features, in accordance with § 401.472. The result of the rehabilitation should be a project that can attract non-subsidized tenants, but competes on rent rather than on amenities. When a range of options exists for satisfying the rehabilitation standard, the PAE must choose the least costly option considering both capital and operating costs and taking into account the marketability of the property and the remaining useful life of all building systems. Nothing in this part exempts rehabilitation from the requirements of part 8 of this title concerning accessibility to persons with disabilities.

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**§ 401.453 Reserves.**

The Restructuring Plan must provide for reserves for capital replacement sufficient to ensure the property's long-term structural integrity so that the property can be maintained as affordable housing in decent, safe, and sanitary condition meeting the standards of § 401.558.

**§ 401.460 Modification or refinancing of first mortgage.**

(a) *Principal amount.* As part of the Restructuring Plan, the PAE will determine the size of the restructured first mortgage that will result from the modification or refinancing of the existing FHA-insured or HUD-held first mortgage. The restructured first mortgage must be in the amount that can be supported by net operating income based on the lower of the restructured section 8 rents or the rents allowed by the Use Agreement under § 401.408. Neither the outstanding principal balance of the existing first mortgage, nor the monthly principal and interest payments on that debt, may be increased through modification under the Restructuring Plan. The debt service coverage used by the PAE must be adequate for purposes of the Restructuring

Plan and for the requirements of any refinancing.

(b) *Fully amortizing.* The modified or refinanced first mortgage must be fully amortizing through level monthly payments.

(c) *Rates and other terms.* Interest rates and other terms of the modified or refinanced first mortgage must be competitive in the market.

(d) *Fees.* Any fees or costs associated with mortgage modification or refinancing determined by the PAE to be above normal processing fees must be paid by the owner from non-project funds and must not be included in the modified or refinanced first mortgage.

(e) *Refinancing.* (1) The owner must contact the mortgagee to determine the mortgagee's willingness to consider a modification and re-amortization of the existing first mortgage through a Restructuring Plan before considering any other source of first mortgage financing. If the mortgagee does not agree to modify and re-amortize in accordance with the Restructuring Plan, the loan must be refinanced.

(2) The refinancing may be either without credit enhancement or with credit enhancement under one of the following:

(i) *FHA mortgage insurance.* If the Restructuring Plan provides for FHA mortgage insurance for the refinanced first mortgage, the insurance will be provided in accordance with all usually applicable FHA legal requirements except that insurance will be documented as provided in section 517(b)(2) of MAHRA. HUD will issue the commitment for mortgage insurance but may adapt its procedures as necessary to facilitate development and implementation of a Restructuring Plan.

(ii) *Other FHA credit enhancement.* If FHA credit enhancement, including risk-sharing, is provided under part 266 of this title, the credit enhancement will be provided in accordance with all usually-applicable FHA legal requirements under part 266 of this title, except that special approval from HUD will be required before the PAE engages in risk-sharing with FHA under part 266 of this title. HUD will approve risk-sharing financing that complies with part 266 whenever required by section 517(b)(3) of MAHRA.

(iii) *Credit enhancement from non-FHA sources.* If credit enhancement is to be provided by a non-FHA source under section 517(b)(4) of MAHRA, HUD will consider waiver of any non-statutory provision in this part only if the waiver will not materially impair achievement of the purposes of MAHRA and if the waiver is essential to meet the legitimate business or legal requirements of the provider of credit enhancement.

**§ 401.461 HUD-held second mortgage.**

(a) *Amount.* (1) The Restructuring Plan must provide for a second mortgage to HUD whenever the Plan provides for either payment of a claim under section 541(b) of the National Housing Act (541(b) claim) or the modification or refinancing of a HUD-held first mortgage that results in a first mortgage with a lower principal amount. The term “second mortgage” in this section also includes a new HUD-held first mortgage (not a refinancing mortgage), if a full payment of claim is made under § 401.471 or if a full payment of claim is unnecessary because surplus project accounts are available to facilitate the Restructuring Plan, pursuant to section 517(b)(6) of MAHRA, or if § 401.460(a) does not permit a restructured first mortgage in any amount.

(2) The second mortgage must be in a principal amount that does not exceed the lesser of:

(i) The amount the PAE reasonably expects to be repaid based on objective criteria such as the amount of anticipated net cash flow, trending assumptions, amortization provisions, and expected residual value of the property; and

(ii) The greater of:

(A) The section 541(b) claim (or the difference between the unpaid principal balance on HUD-held mortgage debt immediately before and after the restructuring), plus surplus project accounts from residual receipts accumulated pursuant to 24 CFR 880.205(e), 881.205(e), or 883.306(e) and derived from an expiring Section 8 Housing Assistance Payments contract and not otherwise distributed to the owner and made available to facilitate the Restruc-

turing Plan pursuant to section 517(b)(6) of MAHRA, and

(B) The difference between the unpaid balance on the first mortgage immediately before and after the restructuring.

(b) *Terms and conditions.* (1) The second mortgage must have an interest rate of at least one percent, but not more than the applicable Federal rate.

(2) The second mortgage must have a term concurrent with the modified or refinanced first mortgage, if any. HUD may provide that if there is no first mortgage, the second mortgage may continue for a term established by HUD.

(3)(i) Principal and interest on the second mortgage is payable only out of net cash flow during its term. “Net cash flow” means that portion of project income that remains after the payment of all required debt service payments on the modified or refinanced first mortgage, if any, including payment of any past due principal or interest, and payment of all reasonable and necessary operating expenses (including deposits to the reserve for replacement account) and any other expenditure approved by HUD.

(ii) The priority and distribution of net cash flow is as follows:

(A) HUD or the PAE may approve the payment to the owner of up to 25 percent of net cash flow based on consideration of relevant conditions and circumstances including, but not limited to, compliance with the management standards prescribed in § 401.560 and the physical condition standards prescribed in § 401.558; and

(B) All remaining net cash flow will be applied to the principal and interest on the second mortgage, until paid in full, and then to any additional subordinate mortgage under § 401.461(c).

(4) HUD may cause the second mortgage to be immediately due and payable on the grounds provided in section 517(a)(4) of MAHRA, including an assumption of the mortgage in violation of HUD standards for approval of transfers of physical assets (if applicable), or if the owner materially fails to comply with other material HUD requirements after a reasonable opportunity for the owner to cure such failure. A decision by HUD in this regard is subject to the